Supreme Court, U.S.
FILED
94 840 NOV 9 1994
OFFICE OF THE CLERK

No. _____

In The

Supreme Court of the United States

October Term, 1994

BENJAMIN B. ALARID, *et al.*,

Petitioners,

v.

SECRETARY OF THE NEW MEXICO DEPARTMENT OF TAXATION AND REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The New Mexico Court Of Appeals

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Does the intergovernmental tax immunity doctrine apply as between the several states so as to render constitutionally invalid a state income tax that discriminates against another sovereign state or those with whom it deals?

2. Is the application by the New Mexico Court of Appeals of the "legal incidence" principle of the intergovernmental tax immunity doctrine, articulated in *United States v. New Mexico*, 455 U.S. 720, 735, n.11, 102 S.Ct. 1373, 1383, n.11, 71 L.Ed.2d 580 (1982), in conflict with the "nondiscrimination" component of the intergovernmental tax immunity doctrine applied by this Court in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 815, n.4, 109 S.Ct. 1500, 1507, n.4, 103 L.Ed.2d 891 (1989)?

LISTING OF ALL PARTIES TO THIS PROCEEDING

Petitioners

Four hundred two individuals are petitioners in this proceeding. All are retired employees of the University of California, or spouses of those employees, and all were parties in the proceedings before the court whose judgment is sought to be reviewed. An alphabetical listing of the petitioners is contained in Appendix A. (App. 1).

Respondent

The Respondent is the Secretary of the New Mexico Department of Taxation and Revenue.

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The opinion of the New Mexico Court of Appeals for which review is sought is reported in *Alarid v. Secretary, Dept. of Tax. & Rev.*, ___ N.M. ___, 878 P.2d 341 (Ct. App. 1994), *cert. denied, Alarid v. Secretary of the New Mexico Dept. of Taxation and Revenue*, ___ N.M. ___, 879 P.2d 91 (1994). The opinion of the New Mexico Court of Appeals is attached as Appendix B. (App. 7). The Order of the New Mexico Supreme Court denying the Petition for Writ of *Certiorari* is attached as Appendix C. (App. 22).

JURISDICTION

The opinion of the New Mexico Court of Appeals is dated June 7, 1994. Petitioners filed a timely Petition for Writ of *Certiorari* with the New Mexico Supreme Court on June 23, 1994. The Petition for Writ of *Certiorari* was denied by the New Mexico Supreme Court on July 19, 1994. *Alarid v. Secretary of the New Mexico Dept. of Taxation and Revenue*, ___ N.M. ___, 879 P.2d 91 (1994). Petitioners then filed a timely Motion for Rehearing of Petition for Writ of *Certiorari* on July 29, 1994. The New Mexico Supreme Court denied the Motion for Rehearing by Order entered August 17, 1994. The New Mexico Supreme Court Order denying the Motion for Rehearing is attached as Appendix D. (App. 23).

This Court's jurisdiction is invoked under 28 U.S.C. § 1257 because the validity of certain state statutes imposing a discriminatory income tax are drawn into question on the ground that the statutes are repugnant to the

doctrine of intergovernmental tax immunity as fashioned from the United States Constitution by this Court.

STATEMENT OF THE CASE

A. Material Facts.

Petitioners are retired employees of the University of California or the spouses of retired employees. The University of California is a public educational institution of the State of California. For decades the University of California has operated the Los Alamos National Laboratory ("LANL") in Los Alamos, New Mexico. By successive contracts with the United States Department of Energy and its predecessor agencies, the University of California has performed scientific research, development and educational services at LANL for the United States government. The employee petitioners were previously employed at LANL performing services under the terms of these contracts. For ease of reference, these successive contracts shall be referred to collectively as the "US/UC Contract."

Pursuant to the express provisions of the US/UC Contract, and funding specifically provided by the United States government, petitioners became eligible upon their retirement from the University of California to receive retirement income from the State of California through the California Public Employees Retirement System ("Cal PERS") the University of California Retirement System ("UCRS"), or both. Cal PERS and UCRS are agencies and instrumentalities of the State of California. These

state agencies are charged by California law with administering California's public employment retirement systems.

The US/UC Contract requires the University of California to pay the employer's share of retirement contributions and administrative costs assessed by Cal PERS and UCRS from a special segregated bank account in which title to the funds remains in the United States government until these retirement contributions and costs are paid. The University of California acquires no right, title or interest in these federal funds other than to pay allowable expenditures to Cal PERS and UCRS as specified in the US/UC Contract.

Petitioners are New Mexico residents. From 1986 through 1989, petitioners received their retirement income through one or both of the California public employment retirement systems in the form of deferred compensation. The State of New Mexico, through the Secretary of the Department of Taxation and Revenue, taxed this retirement income pursuant to NMSA 1978, § 7-2-3 (Repl. Pamp. 1988). That statute provided, in pertinent part, that a tax was to be imposed "upon the net income of every resident individual."

During the same time period, the retirement income paid to New Mexico residents who were formerly employed by New Mexico state educational institutions, but who were otherwise similarly situated to petitioners, was entirely exempt from state income taxation. See NMSA 1978, § 22-11-42(A) (Repl. Pamp. 1988). This exemption was repealed effective January 1, 1990. 1990 N.M. Laws, ch. 49, §§ 17 and 24.

For purposes of the New Mexico income tax, the only material difference between the retirement income of petitioners, which was subject to New Mexico income tax, and the retirement income of retirees of New Mexico's educational institutions, whose retirement income was exempt from such taxation, was that petitioners received their retirement income from the State of California.

B. Presentation Of Federal Questions In The Courts Below

1. The Trial Court

In March 1991, petitioners filed a complaint in the New Mexico district court for Santa Fe County seeking a refund of the state income tax they had paid on their retirement income for the years 1986 through 1989. Petitioners based their claim on the ground that New Mexico's discriminatory income tax was imposed in violation of the *nondiscrimination* component of the intergovernmental tax immunity doctrine ("ITI doctrine"). This constitutional doctrine prohibits taxation by a sovereign where the tax operates to discriminate against another sovereign or those with whom it deals, unless the tax is justified by significant differences between the classes of taxpayers. *See, Davis v. Michigan Dept. of Treasury,* 489 U.S. 803, 812-814, 109 S.Ct. 1500, 1506-1508, 103 L.Ed.2d 891 (1989). The justification may not rest, as here, solely upon the source of the income being taxed. *Id.* at 815.

Petitioners claimed that the nondiscrimination component of the ITI doctrine was implicated in two fundamental respects under the facts of this case:

1. The New Mexico income tax unlawfully discriminated against those who dealt with the sovereign state of California; and/or

2. The New Mexico income tax unlawfully discriminated against those who dealt with the United States government.

The parties submitted these constitutional issues for decision by the trial court on cross-motions for summary judgment on the basis of stipulated material facts. The trial court found in favor of petitioners, concluding that the New Mexico income tax violated the ITI doctrine in *both* of the foregoing respects. The Judgment of the trial court is attached as Appendix E. (App. 24). The trial court's Findings Of Fact And Conclusions Of Law are attached as Appendix F. (App. 27).

Citing this Court's decision in *Davis v. Michigan Dept. of Treasury, supra,* the trial court held that New Mexico's *discriminatory* income tax operated to reduce New Mexico's own employment costs at the expense of another sovereign government and was the type of discriminatory legislation that the ITI doctrine was intended to bar. Appendix F, pages App. 34-35. In the case at bar, petitioners' retirement income had been paid to the petitioners by the State of California through California's public employment retirement systems. Relying upon the holding and rationale of *Davis,* the trial court concluded that the discriminatory taxation of petitioners' retirement income operated to discriminate against those who dealt with the State of California in violation of the ITI doctrine. Appendix F, page App. 35, ¶s 11-12.

The trial court held that neither the federal government *nor* a sovereign state can infringe upon the traditional governmental functions of another sovereign state by the imposition of a *discriminatory* tax. Appendix F, at pages App. 33-34, ¶ 5. The trial court explained:

> Because the injurious effects of a discriminatory tax imposed upon a sovereign state, or those with whom it deals, is exactly the same irrespective of whether the tax is imposed by the federal government or by a sister state, the purpose of the intergovernmental tax immunity doctrine necessarily applies . . . not only to the taxing relationship between the sovereign states and the federal government, *but among the sovereign states as well.*

App. 33-34, ¶ 5 (emphasis added).

In holding that the ITI doctrine applies among the several states, the trial court also relied upon the decision in *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286, 291-292 (1991), *cert. denied*, ___ U.S. ___, 113 S.Ct. 3034, 125 L.Ed.2d 721 (1993). The Arkansas Supreme Court in *Pledger* held that a discriminatory state income tax exemption in favor of retired employees of the state of Arkansas violated the ITI doctrine with respect to nonexempt Arkansas taxpayers who received their retirement income from the governmental agencies of other states. *Pledger*, 811 S.W.2d at 291-292. The Court in *Pledger* drew support for its holding that the ITI doctrine "applies between the states and the federal government and among the states themselves," from this Court's statement in *Davis* that the ITI doctrine forbids the imposition of a heavier tax burden on those who deal with one

sovereign than is imposed on those who deal with the other. *Pledger,* 811 S.W.2d at 291.

Besides holding that the ITI doctrine applies among the several states, the trial court in the case at bar rested its decision on an additional and alternative constitutional ground. The trial court also held that the New Mexico income tax impermissibly discriminated against those who dealt with the United States government. Appendix F, pages App. 34-35, ¶s 8-10.

The trial court reasoned that because petitioners' retirement income had been directly funded by the United States treasury through a special segregated bank account under the terms of the US/UC Contract, the United States treasury sustained a direct economic burden by New Mexico's discriminatory income tax, just as the federal treasury had with respect to the Michigan tax that was struck down by this Court in *Davis v. Michigan Dept. of Treasury, supra.* Appendix F, pages App. 34-35, ¶ 8. Because New Mexico's tax, like the Michigan tax, operated in a *discriminatory* fashion to reduce New Mexico's employment costs at the expense of the federal treasury, the trial court held the New Mexico tax to be violative of the nondiscrimination component of the ITI doctrine on this ground as well. Appendix F, page App. 35, ¶ 10.

2. The Decision Of The Court Of Appeals

The New Mexico Court of Appeals reversed the judgment of the trial court on two grounds. First, while

acknowledging that New Mexico's income tax discriminated against petitioners solely because the source of their retirement income was another sovereign state, the Court of Appeals nevertheless concluded that the "ITI doctrine has no applicability in the context of state-to-state relations." *Alarid v. Secretary, Dept. of Tax. & Rev.*, ___ N.M. ___, 878 P.2d 341, 347 (Ct. App. 1994).

In resolving this constitutional question against petitioners, the Court of Appeals observed that the ITI doctrine is based on the need to protect each sovereign's governmental operations from undue interference by another sovereign. The court concluded that since the power to tax is only coextensive with a sovereign's boundaries, "New Mexico has no ability to affect California's governmental functions by reaching out to tax those functions or employees exerting those functions in California. Thus, the need for each state to protect itself from undue interference from injurious taxes by the other is absent." *Id.* at 347.

The decision of the Court of Appeals to limit application of the ITI doctrine to federal-state relations was influenced by "the fact that no federal case has applied intergovernmental tax immunity between two states." *Id.* at 348. Emphasizing the absence of any federal decisions on this constitutional question, the Court of Appeals determined that the Arkansas Supreme Court decision in *Pledger* was not persuasive because that court relied upon decisions of the United States Supreme Court which dealt solely with the application of the ITI doctrine to overlapping (federal-state) sovereigns, and not with the taxation by one state of another or those with whom it deals. *Id.* at 348.

The Court of Appeals also rejected petitioners' second constitutional claim that New Mexico's income tax unlawfully discriminated against those who dealt with the United States government. In so doing, the court applied the "legal incidence" principle of the ITI doctrine, articulated in *United States v. New Mexico,* 455 U.S. 720, 102 S.Ct. 1373, 71 L.Ed.2d 580 (1982),[1] as opposed to the "nondiscrimination" principle of the ITI doctrine applied in *Davis v. Michigan Dept. of Treasury, supra.*[2]

Finally, in supporting its decision that the New Mexico income tax did not violate the ITI doctrine, the Court of Appeals concluded that the New Mexico tax was not impermissibly discriminatory in that it treated petitioners no differently than the vast majority of other New Mexico

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[1] The Constitution grants immunity from taxation under the "legal incidence" principle where the legal incidence of the tax falls directly upon another sovereign government or an instrumentality of that government. *United States v. New Mexico,* 455 U.S. at 735. Under this principle, if the tax is not imposed directly upon another sovereign government there is no immunity from taxation even though the economic burden of the tax may ultimately be passed on to that government. *Id.* at 735. This Court has expressly cautioned, however, that the "legal incidence" principle does *not* apply if the tax is *discriminatory* in nature. *Id.* at 735, n.11 ("It remains true, of course, that state taxes on contractors are constitutionally invalid if they discriminate against the Federal Government.").

[2] Under the "nondiscrimination" principle of the ITI doctrine, tax immunity is not dependent upon the "legal incidence" of the tax in question, but rather, the controlling issue is whether the tax is discriminatory with respect to the economic burdens that result. *Washington v. United States,* 460 U.S. 536, 544, 103 S.Ct. 1344, 1349, 75 L.Ed.2d 264 (1983); *Davis v. Michigan Dept. of Treasury,* 489 U.S. at 815, n.4.

citizens whose retirement incomes were also subject to the tax. *Alarid*, 878 P.2d at 347.

REASONS FOR ALLOWING THE WRIT

While this Court has recently addressed various aspects of the intergovernmental tax immunity doctrine,[3] no federal court has yet to examine whether intergovernmental tax immunity applies as between the several states so as to invalidate a state income tax that discriminates against another sovereign state or those with whom it deals. This question is squarely presented for decision in this case.

The sources of state and federal tax immunity are distinct, the former arising from the constitutional structure and a concern for protecting state sovereignty, while the latter derives from the Supremacy Clause. *South Carolina v. Baker*, 485 U.S. 505, 518-519, n.11, 108 S.Ct. 1355, 1364, n.11, 99 L.Ed.2d 592 (1988). It is implicit in our governmental structure that the Constitution presupposes and guarantees the continued existence of the States as governmental bodies performing traditional sovereign functions. *Massachusetts v. United States*, 435 U.S. 444, 455,

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[3] *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989) (a state income tax violates the ITI doctrine where it discriminates against retirees of the federal government); *Barker v. Kansas*, ___ U.S. ___, 112 S.Ct. 1619, 118 L.Ed.2d 243 (1992) (ITI doctrine prohibits a state income tax that discriminates against federal military retirees); *Harper v. Virginia*, ___ U.S. ___, 113 S.Ct. 2510, 125 L.Ed.2d 74 (1993) (the decision in *Davis* applies retroactively).

98 S.Ct. 1153, 1161, 55 L.Ed.2d 403 (1978). To safeguard this aspect of the constitutional plan, the modern intergovernmental tax immunity decisions of this Court have fashioned a consistent and reciprocal rule of immunity which bars taxes by one sovereign that *discriminate* against another sovereign or those with whom it deals[4]. *Davis v. Michigan Dept. of Treasury,* 489 U.S. at 811; *South Carolina v. Baker,* 485 U.S. at 523.

This nondiscrimination principle recognizes that the best safeguard against the threat of excessive taxation of another sovereign government, and the most judicially manageable, is the requirement that a government tax in a nondiscriminatory fashion, since the threat of unduly interfering with another sovereign's governmental functions can only be realized if the taxing government is willing to impose the same taxes upon itself. *South Carolina v. Baker,* 485 U.S. at 525, n.15.

Many of the contours of the ITI doctrine are settled. However, what remains unanswered in federal jurisprudence is whether the scope of this constitutional safeguard extends to a state tax that discriminates against another sovereign state or those with whom it deals.[5]

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[4] This Court has recognized that a discriminatory tax *on one who deals with a sovereign government* has as much potential to interfere with governmental functions as a tax on the government itself, and the Court's decisions have therefore required that taxes of this type be imposed equally on similarly situated constituents of the taxing sovereign. *See North Dakota v. U.S.,* 495 U.S. 423, 438, 110 S.Ct. 1986, 1996, 109 L.Ed.2d 420 (1990).

[5] It should be noted that this question was implicated but never reached in *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 103 S.Ct. 692, 74 L.Ed.2d 562 (1983). At issue in that case was the validity under the ITI doctrine of a *discriminatory* bank

Clearly, New Mexico's discriminatory income tax would be unconstitutional if applied to retirees of the federal government, because the tax would operate to reduce New Mexico's employment costs at the expense of the federal treasury. *Davis v. Michigan,* 489 U.S. at 815, n.4. Yet, New Mexico's discriminatory income tax has the very same economic impact on the State of California when the tax is applied to retirees of that state's public employment retirement system. *Cf., Davis v. Michigan,* 489 U.S. at 815, n.4. Under the Constitution, is a sovereign state entitled to a lesser safeguard from another state's *discriminatory* tax than is the federal government? No federal court has addressed the issue, and of the states passing on the question, only New Mexico so holds.

The decisions of the only two state courts which have ruled on this point of constitutional law are in conflict. The Arkansas Supreme Court in striking down Arkansas' discriminatory income tax as applied to the retirement income of civil servant retirees of other sovereign states held that the ITI doctrine applies between the states. *Pledger v. Bosnick,* 306 Ark. 45, 811 S.W.2d 286, 291-292 (1991), *cert. denied,* ___ U.S. ___, 113 S.Ct. 3034, 125

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tax imposed by the state of Tennessee upon interest received by banks on the obligations of the United States, *as well as interest on bonds and other obligations of States other than Tennessee.* 459 U.S. at 394. Whether the ITI doctrine applies among the several states under these circumstances was never addressed in *Memphis* because of a stipulation that if the interest earned on federal obligations were excluded from the computation of the tax obligation of the appellant bank, no tax would be due. *Id.* at 395. The discriminatory state tax was held by this Court to be invalid with respect to the *federal* obligations. *Id.* at 398-399.

L.Ed.2d 721 (1993).[6] The New Mexico Court of Appeals in the case at bar has rejected the holding in *Pledger*, ruling instead that the ITI doctrine has no application in state-to-state relations. *Alarid v. Secretary, Dept. of Tax. & Rev.*, 878 P.2d at 347.

Because of the absence of federal case law on this constitutional issue, and in light of the conflicting decisions by two state courts of last resort, this Court should settle this important question of federal law.

The decision of the New Mexico Court of Appeals also conflicts with decisions of this Court on the question of whether the New Mexico income tax operates to discriminate against those who deal with the United States government. The Court of Appeals confuses two distinct aspects of the ITI doctrine, the "legal incidence" principle, and the "nondiscrimination" principle. This Court has repeatedly *contrasted* these two concepts in applying

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[6] The question whether the ITI Doctrine applies between the states was presented, among other issues, in the Petition for Writ of *Certiorari* filed in this Court on September 3, 1991, in *Pledger v. Bosnick, supra. See, Pledger v. Bosnick*, 60 U.S.L.W. 3276 (U.S. Oct. 8, 1991) No. 91-375. The petition remained pending in this Court for nearly two years while two other aspects of the ITI doctrine, which were likewise raised in *Pledger*, were decided by this Court in related cases. *See, Barker v. Kansas*, 112 S.Ct. at 1622, n.3; *Harper v. Virginia*, 113 S.Ct. at 2515. The Court later denied the Petition for Writ of *Certiorari* on the remaining question in *Pledger*, whether the ITI doctrine applies between the states. *Pledger v. Bosnick*, ___ U.S. ___, 113 S.Ct. 3034, 125 L.Ed.2d 721 (1993), *reh'g denied*, ___ U.S. ___, 114 S.Ct. 25, 125 L.Ed.2d 776 (1993).

the ITI doctrine. In *United States v. New Mexico*, 455 U.S. at 735, n.11, this Court specifically advised:

> With the abandonment of the notion that the economic – as opposed to the legal – incidence of the tax is relevant, it becomes difficult to maintain that federal tax immunity is designed to insulate federal operations from the effects of state taxation. *It remains true, of course, that state taxes on contractors are constitutionally invalid if they discriminate against the Federal Government. . . .*

(Emphasis added).

The decisions of this Court which have shaped the "non-discrimination" principle unequivocally establish that where the economic burden of a *discriminatory* tax ultimately falls upon another sovereign government, the tax violates the ITI doctrine notwithstanding the fact that the legal incidence of the tax does not fall upon the government itself. *See, e.g., Memphis Bank & Trust Co. v. Garner*, 459 U.S. at 397 (where the economic but not the legal incidence of the tax falls on the Federal Government, such a tax generally does not violate the constitutional immunity *if* it does not discriminate against those with whom the Federal Government deals); *United States v. County of Fresno*, 429 U.S. 452, 463, 97 S.Ct. 699, 705, 50 L.Ed.2d 683 (1977) (the economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional *as long as* the tax is imposed nondiscriminatorily on those who deal with the state government); *South Carolina v. Baker*, 485 U.S. at 523 (states can tax private parties doing business with the

federal government even though the financial burden falls on the United States *so long as* the tax does not discriminate against the United States or those with whom it deals); *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 385, 80 S.Ct. 474, 480, 4 L.Ed.2d 384 (1960) ("it does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself.").

The controlling factor relied upon by this Court in *Davis* in striking down Michigan's discriminatory income tax was that the United States government bore the economic burden of Michigan's effort to reduce its employment cost at the expense of the federal treasury, even though the incidence of the Michigan tax did not fall directly upon the federal government itself. *Davis*, 489 U.S. at 815, n.4. The same reasoning applies to the undisputed material facts in this case.

The cost of petitioners' retirement benefits are paid directly from the federal treasury pursuant to the terms of the US/UC Contract. New Mexico's discriminatory income tax, like the discriminatory tax in *Davis*, operates to reduce the State of New Mexico's employment costs at the expense of the federal treasury. This Court's analysis in *Davis* clearly illustrates that subsidization of this type by one sovereign at the expense of another is precluded by the "nondiscrimination" principle of the ITI doctrine, *irrespective* of where the "legal incidence" of the tax lies. *Davis*, 489 U.S. at 815, n.4. By relying on the "legal incidence" principle as the basis for its holding, the decision

of the New Mexico Court of Appeals conflicts irreconcilably with this Court's opinion in *Davis*.[7]

The Court of Appeals also concluded that the New Mexico income tax did not violate the ITI doctrine because it treated petitioners no differently than the vast majority of other New Mexico citizens whose retirement incomes were also subject to the tax. *Alarid*, 878 P.2d at 347 ("[t]he fact that the State has chosen to exempt from state tax one limited class of state retirees does not mean Plaintiffs are being illegally discriminated against.").

This very argument was advanced by Justice Stevens in his sole dissenting opinion in *Davis v. Michigan Dept. of Treasury*, 489 U.S. at 823-824 (Stevens, J. dissenting). The income tax in *Davis* likewise did not discriminate against the vast majority of Michigan residents. Nevertheless, the majority opinion in *Davis*, on the basis of prior precedent, found the tax discriminatory, invalidated the Michigan tax and specifically rejected Justice Steven's dissenting position. *Davis*, 489 U.S. at 815, n.4. Accordingly, the New Mexico Court of Appeals has based its decision upon a minority position that this Court has expressly refused to adopt.

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[7] The New Mexico Court of Appeals distinguished *Davis* "based on the 'incidence' of the tax." *Alarid*, 878 P.2d at 345. However, the "incidence" of the tax challenged in *Davis* was precisely the same as in the case at bar. In both situations the incidence of the tax fell upon the retirement income of the taxpayer-retirees, and not upon the governmental entity paying the retirement income.

CONCLUSION

This case presents two important constitutional questions of first impression in the federal courts. No federal court has determined whether the ITI doctrine applies between the several states. State courts of last resort disagree on this issue. This Court should settle this constitutional question.

The second question involves the proper application of two distinct and contrasting components of the ITI doctrine, the "legal incidence" rule and the "nondiscrimination" rule. The New Mexico Court of Appeals has decided that the former applies to a *discriminatory* tax contrary to a long line of decisions from this Court which deem the incidence of the tax immaterial where the tax is *discriminatory* in nature. This conflict, too, should be resolved by this Court.

PRAYER

Petitioners respectfully ask that the Petition for Writ of *Certiorari* directed to the New Mexico Court of Appeals be granted and that the decision of the New Mexico Court of Appeals be reviewed by this Court.

Respectfully submitted,

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APPENDIX A

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Alarid v. Secretary of New Mexico Department of Taxation & Revenue

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Viola D. LaBerge
John D. LaMotte
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APPENDIX B

IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

BENJAMIN B. ALARID, et al.,

Plaintiffs-Appellees,

vs.

SECRETARY OF THE NEW MEXICO DEPARTMENT OF TAXATION AND REVENUE,

Defendant-Appellant.

No. 13,887
(Filed
June 7, 1994)

APPEAL FROM THE DISTRICT COURT OF SANTA FE COUNTY JOE CRUZ CASTELLANO, JR., District Judge

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OPINION

FLORES, Judge.

This appeal deals with the validity of a state income tax on retirement benefits. The New Mexico Department

of Taxation and Revenue (the Department), appeals from the order granting certain taxpayers (Plaintiffs) summary judgment and ordering the Department to refund the New Mexico state income tax which Plaintiffs paid on their retirement incomes. On appeal, the Department raises the following issues: (1) whether an income tax exemption granted to retirees of New Mexico state educational institutions but not extended to retirees of California state educational institutions discriminates against the federal government in violation of the doctrine of intergovernmental tax immunity (ITI doctrine) when the federal government funds the retirement accounts of the California state educational institution retirees; (2) whether the same exemption discriminates against the sovereign State of California in violation of the ITI doctrine; (3) whether the trial court's decision should be given retroactive effect; and (4) whether the trial court abused its discretion in awarding Plaintiffs certain costs.

We reverse the trial court on issues one and two and accordingly do not address issue three. Furthermore, as to issue four, since we reverse the grant of summary judgment in favor of Plaintiffs, they are not entitled to their costs below. *See* NMSA 1978, § 39-3-30 (Repl. Pamp. 1991).

BACKGROUND

Plaintiffs are retired employees of the University of California or spouses of such employees. The University of California is a public educational institution of the State of California and operates Los Alamos National

Laboratory through a contract with the federal government. Upon their retirement from the laboratory, Plaintiffs became eligible to receive retirement income from the State of California under the California Public Employees Retirement System (CalPERS), the University of California Retirement System (UCRS), or both. Pursuant to its contract with the federal government, the University of California is required to pay the employer's share of retirement contributions and administrative costs assessed by CalPERS and UCRS. The University of California pays these retirement costs from a special segregated bank account in which title to the funds remains in the federal government until payment of these retirement costs is made. The University of California attains no right, title, or interest in these federal funds other than to make allowable expenditures as specified in the contract.

From 1986 through 1989, Plaintiffs, who are New Mexico residents, received their retirement income through one or both of the California retirement plans in the form of deferred compensation. The State of New Mexico, through the Department, taxed this income pursuant to NMSA 1978, Section 7-2-3 (Repl. Pamp. 1988). That statute provided, in pertinent part, that a tax was to be imposed "upon the net income of every resident individual." *Id.*

During the same time period, the retirement income of other New Mexico residents formerly employed by New Mexico state educational institutions was exempt from state taxation. *See generally* NMSA 1978, § 22-11-42(A) (Cum. Supp. 1988). The exemption was repealed effective January 1, 1990. *See* 1990 N.M. Laws, ch. 49, §§ 17, 24.

In March 1991, Plaintiffs filed a complaint seeking a refund of the New Mexico income tax which they paid on their retirement income during the calendar years of 1986 through 1989. Plaintiffs' position was that: (1) the New Mexico income tax exemption discriminated against them based on their dealings with the federal government; and (2) the tax exemption also discriminated against them based on their dealings with the State of California.

Plaintiffs filed a motion for summary judgment claiming that the income tax imposed on their retirement benefits violated the ITI doctrine and, therefore, they were entitled to a refund of those taxes. In a cross-motion for summary judgment, the Department argued that the ITI doctrine was not applicable since the doctrine was concerned solely with relations between a state government and the federal government and the basis for determining who was eligible for the New Mexico tax exemption had nothing to do with the taxpayers' relationship to the federal government.

The trial court found that there were no genuine issues of material fact and concluded that Plaintiffs were entitled to summary judgment as a matter of law because the New Mexico income tax, as applied to Plaintiffs' retirement income, violated the ITI doctrine. The trial court ordered the Department to determine the refund amounts due Plaintiffs for the years 1986 through 1989 and to distribute such amounts accordingly.

DISCUSSION

The Department timely appeals and seeks reversal of the grant of summary judgment to Plaintiffs. Summary

judgment "is proper only when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law[.]" *Hyden v. Law Firm of McCormick, Forbes, Caraway & Tabor*, 115 N.M. 159, 163, 848 P.2d 1086, 1090 (Ct. App.), *cert. denied*, 115 N.M. 60, 846 P.2d 1069 (1993). It is a remedy which should be applied with great caution. *Id.*

The trial court granted Plaintiffs summary judgment on the basis that the taxation of Plaintiffs' retirement income operates to discriminate against those who deal with the federal government and the sovereign State of California in violation of the ITI doctrine. The ITI doctrine is based on the need to protect one sovereign's governmental operations from undue interference by another sovereign. *See Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 814 (1989). In general, the ITI doctrine prohibits taxes that are imposed directly on one sovereign by another or that discriminate against a sovereign or those with whom the sovereign deals. *Id.* at 811.

The ITI doctrine was developed early in the history of the Republic "to help weld our federal system into a viable Nation, by providing a safeguard for federal operations against hampering or crippling state and local taxation." Paul J. Hartman, *Federal Limitations on State and Local Taxation* § 6:1, at 220 (1981). From its genesis it was recognized that the pivotal point in the application of the ITI doctrine was a question of supremacy within the context of federalism. David M. Richardson, *Federal Income Taxation of States*, 19 Stetson L. Rev. 411, 414-15 (1990). Chief Justice Marshall eloquently and elaborately set forth the rationale of the doctrine in the landmark case *McCulloch v. Maryland*:

> That the power of taxing [the National Bank] by the states may be exercised so as to destroy it, is too obvious to be denied. But taxation is said to be an absolute power, which acknowledges no other limits than those expressly prescribed in the constitution, and like sovereign power of every other description, is intrusted to the discretion of those who use it. But the very terms of this argument admit, that the sovereignty of the state, in the article of taxation itself, is subordinate to, and may be controlled by the constitution of the United States. How far it has been controlled by that instrument, must be a question of construction. In making this construction, no principle, not declared, can be admissible, which would defeat the legitimate operations of a supreme government.

17 U.S. 316, 427 (1819).

The philosophical underpinnings of the *McCulloch* case thus appear to be grounded solidly in the Supremacy Clause, and the early cases were in harmony with these underpinnings. *See Dobbins v. Commissioners of Erie County*, 41 U.S. 434, 448-49 (1842) (invalidating state tax on federal employee). However, in the last part of the last century, *McCulloch* was read expansively to bar most taxation by one sovereign of another. *See Collector v. Day*, 78 U.S. 113, 124 (1870) (invalidating federal tax on state employee). Earlier this century, the Supreme Court considerably narrowed the ITI doctrine, first by holding that the federal government could levy on a state employee a tax that did not threaten essential governmental functions, *see Helvering v. Gerhardt*, 304 U.S. 405, 424 (1938), and the very next year by overruling the *Dobbins-Day* line of cases and holding that the federal government could

levy nondiscriminatory taxes on government employees, including state government employees, *see Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 486-87 (1939).

Based on this history, Plaintiffs contend that the modern ITI doctrine bars any taxes that discriminate in any way against a person who deals with the federal government or a person who deals with the government of another state. As will be seen, however, in making such an argument Plaintiffs ignore the concept of sovereignty that is at the heart of the ITI doctrine. Thus, although the ITI doctrine has had an uneven course, the polestar in its application remains whether and to what extent the state tax at issue will impinge upon a legitimate governmental goal of another sovereign. *See* Note, *Supreme Court Decisions in Taxation: 1981 Term*, 36 Tax Law. 421, 482-85 (1983). It is against this basic standard that we must judge the Plaintiff's arguments.

I. The Incidence of the Tax Does Not Fall On or Discriminate Against the Federal Government

Relying on *Davis*, the trial court first reasoned that because Plaintiffs' retirement benefits were ultimately paid by the federal government, those benefits were entitled to the same immunity from state taxation afforded to the *Davis* employees whose retirement income was also paid by the federal government. *Davis* is distinguishable from the present case based on the "incidence" of the tax. Moreover, not only did the New Mexico tax not fall on the United States, but also the tax did not discriminate against Plaintiffs based on their dealings with the federal government.

Davis held that an income tax exemption granted to a state's own retirees, but not extended to federal retirees, violated the ITI doctrine as codified in 4 U.S.C. § 111 (1988). In *Davis*, the only difference between the two classes of taxpayers was the source of their income. Employees whose retirement income was received from the State of Michigan were exempt from state taxation, while employees whose retirement income was received from the federal government were not exempt. Thus, under *Davis*, it was held a violation of 4 U.S.C. § 111 for a state to discriminate against the federal government by exempting only that retirement income received from the state, while not exempting retirement income received from the federal government.

The parties here stipulated that the source of Plaintiffs' income was not the federal government, but rather the State of California. Therefore, 4 U.S.C. § 111, the cornerstone of *Davis*, does not apply. Although the cost of Plaintiffs' retirement benefits was ultimately passed on to the federal government under the terms of its contract with the University of California, this fact is irrelevant because the "legal incidence" of the tax does not fall upon the federal government or its instrumentalities. *See United States v. County of Fresno*, 429 U.S. 452, 459 (1977) ("States may not impose taxes directly on the Federal Government, nor may they impose taxes the legal incidence of which falls on the Federal Government."). In this regard, the United States Supreme Court has stated:

> [U]nder [the] current intergovernmental tax immunity doctrine the States can never tax the United States directly but can tax any private parties with whom it does business, even

> though the financial burden falls on the United States, as long as the tax does not discriminate against the United States or those with whom it deals. . . . A tax is considered to be directly on the Federal Government only "when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities."

South Carolina v. Baker, 485 U.S. 505, 523 (1988) (citations omitted) (quoting *United States v. New Mexico*, 455 U.S. 720, 735 (1982)).

In this case, the tax on Plaintiffs' retirement income fell directly on Plaintiffs based on their status as residents of New Mexico. Sections 7-2-3 or 22-11-42 did not mandate that the tax be passed on to the State of California or the federal government. Furthermore, Plaintiffs and the federal government are not so closely connected that they cannot be viewed as separate entities. Plaintiffs were employees of the University of California and the retirement benefits were paid to Plaintiffs because they were employed by the State of California, not the federal government. The only relationship between the federal government and Plaintiffs was the fact that the costs of Plaintiffs' retirement benefits were passed on to the federal government under the terms of the federal government's contract with the University of California. This tenuous relationship does not satisfy us that Plaintiffs and the federal government should be considered as one entity. Also, the fact that the University of California operated Los Alamos National Laboratory through funding provided by a contract with the federal government does not mean that the University of California is a party

with whom the federal government deals for intergovernmental immunity tax purposes. *See Baker,* 485 U.S. at 520.

When the legal incidence of a state tax falls upon an entity doing business with the federal government, it is the incidence of the tax and not the indirect economic consequences that determines whether a tax is barred by federal constitutional immunity. *North Dakota v. United States,* 495 U.S. 423, 439 (1990); Charles A. Trost, *Federal Limitations on State and Local Taxation* § 6:15, at 312 (1993 Supp.). The United States Supreme Court upheld the imposition of New Mexico taxes in a virtually identical factual scenario in *United States v. New Mexico,* 455 U.S. 720 (1982). Two of the corporations involved in that case performed various tasks under contract with the United States Department of Energy in the management, maintenance, construction, and repair of the very same Los Alamos National Laboratory where the present plaintiffs were employed prior to their retirement. As in the present case, the contracts provided that contractors would pay employees directly from special segregated bank accounts in which title to the funds remained in the federal government. The United States argued, inter alia, that the salaries paid by its contractors should not be subjected to New Mexico tax because the contractors were agents of the federal government. Speaking for a unanimous court, Justice Blackmun framed the issue as "whether the contractors can realistically be considered entities independent of the United States." *Id.* at 738. The Court recognized that the current trend is not to limit states' taxation authority where there is no direct burden upon the federal government and examined the details of the federal relationship with the contractors providing

the services at the Los Alamos National Laboratory. The Court concluded "[t]he congruence of professional interests between the contractors and the Federal Government is not complete[.]" *Id.* at 740. The Court therefore upheld the imposition of New Mexico's gross receipts tax upon the salaries paid by the federal contractors to their employees working at the Los Alamos National Laboratory.

Plaintiffs, however, argue that the New Mexico tax discriminates against them based on their relation to the federal government. As *United States v. New Mexico* illustrates, Plaintiffs do not receive their retirement payments from the federal government for purposes of constitutional tax immunity analysis. The discriminatory impact of which they complain is therefore not directed toward the federal government and is not prohibited.

Once again, tracing the ITI doctrine to its roots makes this point abundantly clear. In *McCulloch,* Chief Justice Marshall examined the rationale behind prohibiting states from imposing discriminatory taxes upon federal instrumentalities:

> The people of a state, therefore, give to their government a right of taxing themselves and their property, and as the exigencies of government cannot be limited, they prescribe no limits to the exercise of this right, resting confidently on the interest of the legislator, and on the influence of the constituent over their representative, to guard them against its abuse. But the means employed by the government of the Union have

> no such security, nor is the right of a state to tax them sustained by the same theory.

17 U.S. at 428.

In the present case, Plaintiffs are New Mexico residents and with regard to state taxation may rest "confidently on the interest of the legislator, and on the influence of the constituent[s] over their representative, to guard against its abuse." *Id.; see also Brown v. Mierke,* No. 90-C-3341, 1994 WL 96685, at *5 (W. Va. Mar. 24, 1994) (protection of the politically weak is a cornerstone of ITI doctrine). In this regard, Plaintiffs are no different than the vast majority of other New Mexico citizens whose retirement incomes are also subject to New Mexico income tax. The fact that the State has chosen to exempt from state tax one limited class of state retirees does not mean Plaintiffs are being illegally discriminated against. *See Brown,* 1994 WL 96685, at *1; *Schnorbus v. Director of Revenue,* 790 S.W.2d 241, 242 (Mo. 1990) (en banc), *cert. denied,* 498 U.S. 1027 (1991). As Justice Stevens said in his concurrence in *Barker v. Kansas,* "[a] state tax burden that is shared equally by federal retirees and the vast majority of the State's citizens does not discriminate against those retirees." 112 S.Ct. 1619, 1626 (1992); *see also,* Richardson, *supra,* at 436 (state tax violates ITI only if purpose or effect of discrimination is to shift operating costs to the other government).

For these reasons, we hold that the trial court erred by concluding that the tax violated the ITI doctrine based on Plaintiffs' dealings with the federal government.

II. Tax Discrimination Based on Dealings With the State of California

The trial court also based its grant of summary judgment on the fact that it found that the tax operated to discriminate against those who deal with the State of California in violation of the ITI doctrine. There is no doubt that the tax discriminates against employees who are residents of New Mexico, but whose source of income is from another state's educational institution. However, we agree with the Department that the ITI doctrine has no applicability in the context of state-to-state relations.

Our decision rests on the fact that the ITI doctrine is based on the need to protect each sovereign's government operations from undue interference by another sovereign. *See Davis*, 489 U.S. at 814. The federal government has the ability to tax activities within New Mexico, and can thereby affect New Mexico's ability to carry out its governmental functions. Similarly, in limited circumstances, New Mexico can impose taxes on the federal government and affect its governmental functions. Therefore, the need for each sovereign to protect itself from undue interference is clearly present in the case of the overlapping sovereignty of the state and federal governments, and the ITI doctrine is applicable. Hartman, *supra*, § 6:19, at 333-39.

The power to tax is, however, only coextensive with a sovereign's boundaries. *McCulloch*, 17 U.S. at 428-29. Unlike the federal government whose sovereignty overlaps that of all of the states, California does not have the ability to affect governmental functions in New Mexico by imposing taxes. Similarly, New Mexico has no ability

to affect California's governmental functions by reaching out to tax those functions or employees exerting those functions in California. Thus, the need for each state to protect itself from undue interference from injurious taxes by the other is absent. Consequently, there is no basis on which to apply the ITI doctrine. *Cf.* Kenda K. Tomes, *State Taxation of Puerto Rican Obligations: An Interest(ing) Question,* 66 Chi.-Kent L. Rev. 903, 938 (1990) (the Constitution does not prohibit a state from taxing the income received by its residents from bonds issued by another state).

We find support for this result not only in the philosophical underpinnings of the ITI doctrine but also in the fact that no federal case has applied intergovernmental tax immunity between two states. In fact, all federal cases cited by Plaintiffs in support of their argument dealt with intergovernmental tax immunity between the federal government and the states. Plaintiffs' only support comes from the state case of *Pledger v. Bosnick,* 811 S.W.2d 286 (Ark. 1991), *cert. denied,* 113 S.Ct. 3040 (1993). *Pledger* held that a statutory exemption from Arkansas income tax for the retirement income received by Arkansas state retirees unconstitutionally discriminated against other Arkansas residents who received retirement income from employment with United States civil service agencies, branches of the United States armed forces, and other states' agencies and political subdivisions. As such, *Pledger* confronted the same question which faces us today.

In concluding that the ITI doctrine applied between the states, the *Pledger* court relied on *Davis* and *Phillips Chemical Co. v. Dumas Independent School District,* 361 U.S. 376 (1960). However, we believe *Pledger's* reliance on

these cases is misplaced. In both *Davis* and *Phillips* the Court dealt only with the application of the ITI doctrine to overlapping sovereigns and did not apply the ITI doctrine to taxation of one state by another state. We see no other analysis in *Pledger* which supports application of the ITI doctrine in this context. Consequently, we do not find *Pledger* persuasive.

For the reasons stated, we hold that the ITI doctrine is not applicable.

CONCLUSION

We reverse the trial court's summary judgment granted in favor of Plaintiffs as well as the trial court's award of costs to Plaintiffs.

IT IS SO ORDERED.

/s/ Benny E. Flores
BENNY E. FLORES, Judge

WE CONCUR:

/s/ Lynn Pickard
LYNN PICKARD, Judge

/s/ Bruce D. Black
BRUCE D. BLACK, Judge

APPENDIX C

IN THE SUPREME COURT OF THE STATE OF NEW MEXICO
Tuesday, July 19, 1994

NO. 22,205

BENJAMIN B. ALARID, et al.,

Plaintiffs-Petitioners,

vs.

SECRETARY OF THE NEW MEXICO DEPARTMENT OF TAXATION AND REVENUE,

Defendant-Respondent.

ORDER

This matter coming on for consideration by the Court upon petition for writ of certiorari, and the Court having considered said petition and response, and being sufficiently advised;

NOW, THEREFORE, IT IS ORDERED that petition for writ of certiorari is denied.

IT IS FURTHER ORDERED that the Record in Cause No. **13887** is returned to the Clerk of the Court of Appeals.

ATTEST: A True Copy

KATHLEEN JO GIBSON
CLERK OF THE SUPREME COURT

By /s/ Jane Gurulé
Chief Deputy

APPENDIX D

IN THE SUPREME COURT OF THE STATE OF NEW MEXICO
August 17, 1994

NO. 22,205

BENJAMIN B. ALARID, et al.,

Plaintiffs-Petitioners,

vs.

SECRETARY OF THE NEW MEXICO DEPARTMENT OF TAXATION AND REVENUE,

Defendant-Respondent.

ORDER

This matter coming on for consideration by the Court upon motion for rehearing of the denial of petition for writ of certiorari, and the Court having considered the motion and being sufficiently advised;

NOW, THEREFORE, IT IS ORDERED that the motion hereby is DENIED.

ATTEST: A TRUE COPY

/s/ Kathleen Jo Gibson
Clerk of the Supreme Court
of the State of New Mexico

APPENDIX E

FIRST JUDICIAL DISTRICT COURT
COUNTY OF SANTA FE
STATE OF NEW MEXICO

BENJAMIN B. ALARID, et al., Plaintiffs, vs. SECRETARY OF THE NEW MEXICO DEPARTMENT OF TAXATION AND REVENUE, Defendant.	)	No. SF 91-593(C)

SUMMARY JUDGMENT IN FAVOR OF THE TAXPAYER PLAINTIFFS

THIS MATTER came before the Court upon plaintiffs' Motion for Summary Judgment against the defendant, Secretary of the New Mexico Department of Taxation and Revenue ("Secretary"). Plaintiffs seek an order enjoining the Secretary to refund income taxes paid by the plaintiffs to the State of New Mexico based on plaintiffs' retirement income for the years 1986 through 1989 on the ground that the New Mexico income tax, as applied to plaintiffs' retirement income, violates the federal constitutional doctrine of intergovernmental tax immunity. The Secretary filed a Cross-Motion For Summary Judgment seeking a determination by the Court that the New Mexico income tax on plaintiffs' retirement income did not violate the intergovernmental tax immunity doctrine. The Court has carefully considered the pleadings, the Stipulated Statement of Material Facts entered into by the parties, the

extensive briefs, oral arguments of the parties presented at the hearing on January 24, 1992, and proposed findings of fact and conclusions of law submitted by the parties. The Court, being fully advised in the premises, hereby determines that there are no genuine issues of material fact and that the plaintiffs are entitled to judgment herein as a matter of law. The Court's Findings Of Fact and Conclusions Of Law are attached hereto, and are hereby incorporated in this Summary Judgment by reference.

THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that plaintiffs be, and hereby are, awarded judgment in this cause against the defendant as a matter of law. In accordance therewith, the court ORDERS as follows:

1. The Secretary shall, as promptly as practicable, determine the amount of New Mexico income tax that was paid by each of the plaintiffs on their respective retirement income from the State of California for the years 1986, 1987, 1988 and 1989.

2. The Secretary shall thereupon prepare for each plaintiff taxpayer an individual refund check made payable to the taxpayer in the amount determined by the Secretary, with the approval of plaintiffs' counsel, to be due to each plaintiff, together with interest on such amount at the statutory rate of 15% per year, computed at the rate of one and one-fourth percent (1 1/4%) per month or fraction thereof, from the date of each taxpayer's claim for refund, in accordance with § 7-1-68, NMSA 1978.

3. The Secretary shall thereupon deliver said refund checks to plaintiffs' counsel, Jones, Snead, Wertheim, Rodriguez & Wentworth, P.A., for ultimate distribution to plaintiffs in accordance with the employment agreement between plaintiffs and their counsel.

4. Plaintiffs shall be awarded their costs of this action.

JOE CRUZ CASTELLANO JR.
DISTRICT JUDGE

SUBMITTED UPON NOTICE OF PRESENTMENT:

JONES, SNEAD, WERTHEIM, RODRIGUEZ &
WENTWORTH, P.A.
Attorneys for Plaintiffs

By /s/ A.L. JARAMILLO
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APPROVED AS TO FORM:

/s/ Margaret B. Alcock
FRANK D. KATZ, ESQ.
MARGARET B. ALCOCK, ESQ.
Special Assistant Attorney General
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Santa Fe, New Mexico 87504-0630

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APPENDIX F

FIRST JUDICIAL DISTRICT COURT
COUNTY OF SANTA FE
STATE OF NEW MEXICO

BENJAMIN B. ALARID, et al.,	)	No. SF 91-593(C)
Plaintiffs,	)	
vs.	)	
SECRETARY OF THE NEW MEXICO DEPARTMENT OF TAXATION AND REVENUE	)	
Defendant.	)	

THE COURTS' FINDINGS OF FACT AND CONCLUSIONS OF LAW

THE COURT finds and concludes in this cause as follows:

FINDINGS OF FACT

1. The Court has jurisdiction over the parties and the subject matter of this action and venue is properly laid in this judicial district.

2. Plaintiffs are individuals who were formerly employed by the University of California prior to the commencement of this action ("employee plaintiffs") or spouses of such employee plaintiffs ("spouse plaintiffs") or both. The term "plaintiffs," as used herein, applies collectively to all plaintiffs.

3. The University of California is a public educational institution of the State of California, administered by a public corporation known as "The Regents of the University of California."

4. At times material to this proceeding, and for several decades, the University of California by successive written contracts with the United States of America and, more particularly, the United States Department of Energy and its predecessor agencies (hereinafter referred to as "the Federal Contract"), was engaged in the operation of the Los Alamos National Laboratory in Los Alamos, New Mexico. Pursuant to the Federal Contract, the University of California performed research, development and educational activities for military and or peaceful applications on behalf of the Federal government in the national public interest. Various provisions of the Federal Contract pertinent to the issues in this case are attached as Exhibit "1" to the Stipulated Statement of Material Facts filed by the parties in this action. The Court hereby incorporates by reference those contractual provisions into its Findings as if fully set forth herein.

5. The employee plaintiffs were formerly employed by the University of California performing services required by the Federal Contract at the Los Alamos National Laboratory.

6. As a material part of their employment with the University of California, and through direct funding specifically provided by the Federal Government under the "Costs and Expenses" and "Payments and Advances" Clauses of the Federal Contract, the employee plaintiffs became eligible, upon retirement, to receive retirement

income from the State of California under the California Public Employees Retirement System ("PERS") or the University of California Retirement System ("UCRS"), or both, in accordance with the laws of the State of California.

7. PERS and UCRS are agencies and instrumentalities of the State of California, charged by California law with administering statutorily created retirement systems for the benefit of retired public employees of the State of California, including, retired employees of the University of California such as the employee plaintiffs.

8. During one or more of the calendar years 1986, 1987, 1988 and 1989, each of the employee plaintiffs were retired employees of the University of California, and each received retirement income from the State of California through PERS, UCRS, or both. This retirement income constitutes deferred compensation for past years of service rendered by the employee plaintiffs under the Federal Contract as employees of the University of California. The plaintiffs' retirement income was specifically funded by the Federal Government as provided in the Federal Contract.

9. During one or more of the calendar years 1986, 1987, 1988 and 1989, each of the spouse plaintiffs had a financial and legal interest in the retirement income benefits paid to his or her employee spouse by the State of California.

10. Some or all of the retirement income received by the plaintiffs from the State of California during one or more of the calendar years 1986, 1987, 1988 and 1989 was received by them while they were residents of the State of

New Mexico. Such retirement income is hereinafter referred to as "the subject retirement benefits."

11. For one or more of the calendar years 1986, 1987, 1988 and 1989, the State of New Mexico, through the Secretary, imposed and collected from the plaintiffs income taxes on the subject retirement benefits under the authority of the New Mexico Income Tax Act, and specifically, § 7-2-3, NMSA 1978.

12. At times material to this action, certain educational institutions of the State of New Mexico, including, the University of New Mexico (UNM), New Mexico State University (NMSU) and New Mexico Institute of Mining and Technology (NM Tech), by written contracts with the United States of America ("Government Contracts"), were engaged in the performance of services in New Mexico comprising research, development and educational activities for military and/or peaceful applications on behalf of the Federal Government in the national public interest.

13. As a material part of their employment with UNM, NMSU and NM Tech, and other educational institutions of the State of New Mexico, and pursuant to the costs and expenses provisions and funding by the federal government as provided in the Government Contracts, employees of these New Mexico educational institutions who performed services required by the Government Contracts ("New Mexico Educational Employees") became eligible, upon retirement from such employment, to receive retirement income benefits paid by the State of New Mexico under the New Mexico Educational Retirement Act ("ERA") in accordance with the laws of the

State of New Mexico. Such retirement benefits were received by retired New Mexico Educational Employees for the years 1986 through 1989, and constitute deferred compensation for past years of service by such retired employees to the respective New Mexico educational institutions.

14. For the calendar years 1986, 1987, 1988 and 1989, the State of New Mexico, pursuant to § 22-11-42, NMSA 1978, exempted from New Mexico income taxation the retirement income paid to New Mexico Educational Employees by the State of New Mexico under the ERA. That statutory exemption provided that "contributions or benefits mentioned in the Educational Retirement Act shall . . . be exempt from any state income tax."

15. For purposes of the New Mexico Income Tax Act, the difference between the employment and retirement income of the plaintiffs, whose retirement income was subject to income tax in New Mexico, and the employment and retirement income of New Mexico Educational Employees, whose retirement income was exempt from income taxation in New Mexico, was that the employee plaintiffs were employed by a public university which was part of a sovereign state other than New Mexico, specifically, the State of California, and the ultimate source of plaintiffs' retirement income was the State of California, whereas, the New Mexico Educational Employees whose retirement income was exempt from income taxation in New Mexico, were employed by public educational institutions which were a part of the sovereign State of New Mexico and the ultimate source of their retirement income was the State of New Mexico.

16. Pursuant to § 7-1-26(A), NMSA 1978, the plaintiffs have each filed a timely application for refund of New Mexico state income taxes paid by them on the subject retirement benefits with the Secretary for one or more of the calendar years 1986, 1987, 1988 and 1989, claiming, *inter alia*, that the New Mexico income tax, as applied to plaintiffs' retirement income, violates the federal constitutional doctrine of intergovernmental tax immunity.

17. The Secretary has denied each of the plaintiffs' applications for refund.

18. The State of New Mexico, by § 7-1-26, NMSA 1978, permits any person who has made a tax payment or who has had withheld from him a tax in excess of that for which he is liable to obtain a refund by applying to the Secretary within the statute of limitations.

19. Plaintiffs have timely commenced this civil action for refund of the state income taxes paid by them in excess of that for which they were liable, together with applicable interest.

CONCLUSIONS OF LAW

1. The modern doctrine of intergovernmental tax immunity prohibits discriminatory taxation by one sovereign government against another sovereign government or those with whom it deals.

2. The rationale underlying the modern doctrine of intergovernmental tax immunity is that a discriminatory tax imposed upon another sovereign government or those

with whom it deals can be escalated by the taxing sovereign so as to impair or potentially destroy the traditional governmental functions of the sovereign being taxed, causing that sovereign government, for example, to be unable to hire employees or causing it to pay prohibitively high salaries or employment benefits.

3. The non-discrimination principle at the heart of modern intergovernmental tax immunity case law recognizes that the best safeguard against such excessive taxation, and the most judicially manageable, is the requirement that a sovereign government tax in a non-discriminatory fashion. Where a government imposes a non-discriminatory tax, the threat of impairing another government can be realized only if the taxing government is willing to impose taxes that will also impair itself or its constituents.

4. In extending the protection of the intergovernmental tax immunity doctrine to individuals who deal with a sovereign government, the Supreme Court decisions recognize the principle that a discriminatory tax on one who deals with a sovereign government has as much potential to obstruct traditional governmental functions as a discriminatory tax imposed on the sovereign government itself.

5. It is implicit in the constitutional scheme of our federal republic that neither the federal government nor a sovereign state can, by the imposition of a discriminatory tax, impair or interfere with the traditional governmental functions of another sovereign state. Because the injurious effects of a discriminatory tax imposed upon a sovereign state, or those with whom it deals, is exactly

the same irrespective of whether the tax is imposed by the federal government or by a sister state, the purpose of the intergovernmental tax immunity doctrine necessarily applies to both taxing relationships. Accordingly, the intergovernmental tax immunity doctrine necessarily applies not only to the taxing relationship between the sovereign states and the federal government, but among the sovereign states as well.

6. Under the intergovernmental tax immunity doctrine, the imposition of a heavier tax burden on those who deal with one sovereign government than is imposed upon those who deal with the other must be justified by significant differences between the two classes of taxpayers.

7. The only significant difference between the plaintiff taxpayers, whose retirement income was subject to New Mexico income tax, and similarly situated retirees of New Mexico's educational institutions, whose retirement income was exempt from the New Mexico income tax, was the ultimate source of their respective retirement income.

8. The plaintiffs' retirement income at issue in this case is directly and specifically funded from the federal treasury by operation of the advance funding and costs and expense provisions of the Federal Contract. Accordingly, the Federal Government bears a direct economic burden of New Mexico's discriminatory taxation of plaintiffs' retirement income in the same manner as it did in the discriminatory tax imposed by the State of Michigan

on the retirement income of federal retirees, which discriminatory tax was struck down in *Davis v. Michigan*, 489 U.S. 803 (1989).

9. Discriminatory taxes, such as the tax at issue in this case, enacted to reduce New Mexico's employment costs at the expense of federal treasury, are the type of discriminatory taxation that the constitutional doctrine of intergovernmental tax immunity was intended to bar.

10. The discriminatory taxation of plaintiffs' retirement income operates under the circumstances presented in this case to discriminate against those who deal with the Federal Government in violation of the constitutional doctrine of intergovernmental tax immunity.

11. Additionally, or alternatively, plaintiffs' retirement income is received from the sovereign State of California, and New Mexico's discriminatory taxation of such retirement income operates to reduce New Mexico's employment costs at the expense of the sovereign State of California, and accordingly, is the type of discriminatory taxation that the doctrine of intergovernmental tax immunity was intended to bar.

12. The discriminatory taxation of plaintiffs' retirement income operates under the circumstances presented in this case to discriminate against those who deal with the sovereign State of California in violation of the constitutional doctrine of intergovernmental tax immunity.

13. In passing upon the constitutionality of the New Mexico income tax as applied to the plaintiffs' retirement income and the circumstances presented in this case, this

Court must look beyond empty formalisms to the substance and practical operation of New Mexico's discriminatory income tax.

14. The State of New Mexico in § 7-1-26, NMSA 1978, has consented to this suit and to the refund of income taxes paid by the plaintiffs in excess of those for which they were liable by providing that its taxpayers may recover all illegally collected taxes by timely applying for a refund.

15. The Court's decision in this case does not establish a new principle of law. The extensive history of the intergovernmental tax immunity doctrine demonstrates that it has been applied for decades to strike down discriminatory taxation such as that at issue here. The Court's decision in this case is, therefore, a statement of the applicability of a long-standing doctrine to the facts and circumstances presented in this case.

16. The principles underlying the intergovernmental tax immunity doctrine are materially advanced by application of that constitutional doctrine to the facts and circumstances presented in this case. To deny plaintiffs their statutory and legal right to a refund of taxes imposed and collected in violation of the federal Constitution would compound one illegal act with another.

JOE CRUZ CASTELLANO JR.
DISTRICT JUDGE

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